Nos. 37 and 38

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1957

UNITED STATES OF AMERICA,
Appellant,
vs.
TOWNSHIP OF MUSKEGON, a Municipal Corporation, et al.

CONTINENTAL MOTORS CORPORATION, ETC.,
Appellant,
vs.
TOWNSHIP OF MUSKEGON, a Municipal Corporation, et al.

ON APPEALS FROM THE SUPREME COURT OF THE STATE OF MICHIGAN

BRIEF FOR APPELLEES

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SUBJECT INDEX

INDEX TO CASES AND AUTHORITIES CITED

QUESTION PRESENTED

May a state impose a tax upon the privilege of using tax-free property (including federally-owned property) in connection with a business conducted for profit, and measure such tax by the value of the property so used?

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BRIEF FOR APPELLEES

STATEMENT

(Italics used throughout this Brief are ours unless otherwise indicated)

We believe a more complete statement of the factual background of the case than that contained in appellants' brief will help to clarify the issues.

The land involved was originally deeded by Continental Aviation and Engineering Corporation, a subsidiary of Continental Motors Corporation, to Defense Plant Corporation by deeds dated October 18, 1943 and April 4, 1945 (R. 28). A large manufacturing plant, variously

referred to as the Continental Aviation Plant, the Getty Street Plant and Plancor 166, costing in excess of eight million dollars, was constructed thereon through the use of funds furnished by the Reconstruction Finance Corporation (R. 24). The land was leased under various arrangements to Continental Aviation thereafter.*

The land remained subject to local tax so long as title remained in D.F.C. or R.F.C. See Act of June 22, 1932, 47 *Stat.* 9.

The property was declared surplus in 1946 and accountability therefore acknowledged by War Assets Administration in 1948. On April 1, 1949, the premises were leased by R.F.C., acting through W.A.A., to Continental Motors Corporation, at a rental of $364,032.00 per year. The lease required Continental to pay all taxes assessed relative to the premises and was to run until March 31, 1954. The lease was cancelled as of October 31, 1950. Since that time Continental has occupied the premises under a "permit" as set out in appellants' statement.*

Act 189 of 1953, originating as House Bill No. 46, introduced January 28, 1953, was adopted by unanimous vote of both houses of the Michigan legislature and became effective June 10, 1953 (R. 70-78).

By deed dated May 6, 1953, recorded December 9, 1953, the land was conveyed by R.F.C. to the United States of America.*

The plant has at all times pertinent here been used by Continental "in connection with a business conducted for profit" and a profit derived from such use (R. 22).

SUMMARY OF ARGUMENT

Appellants adopt much of the argument in the appellants' brief in the case of *U. S. and Borg-Warner Corp. vs. City of Detroit*, No. 26. Appellees find it impractical to follow a similar procedure and submit a brief independently of the appellee's brief in the Borg-Warner case.

Act 189 imposes a tax upon the privilege of using exempt property in connection with a business conducted for

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*See *Continental Motors et al. vs. Twp. of Muskegon, et al.*, 346 Mich. 140.

profit. It does not impose a tax upon any property. While the value of property, including federally-owned property, is used as a measure for the tax, the tax is never on the property since the tax does not become effective and "can in no case have any incidence" unless the privilege, which is the subject of the tax, is exercised. *Fox Film Corp. vs. Doyle*, infra.

Ever since the decision of *James V. Dravo Contracting Co.*, infra, followed by *Alabama vs. King & Boozer*, infra, it has been uniformly held that the "legal incidence" rather than the "burden of the tax" is the controlling factor in determining whether a tax violates the immunity rule. Independent contractors are no longer regarded as "agents or instrumentalities" of the federal government within the immunity doctrine even though their activities are confined solely to performing work for the federal government. The legal incidence of the tax imposed by Act 189 falls squarely on Continental Motors Corporation, an independent contractor, engaged in business for profit.

It is well established that a tax on the privilege of enjoying the beneficial use of property may be measured by the value of non-taxable property if such property is used in connection with the privilege taxed. The only Constitutional requirements are that the measure employed be reasonable and that the tax be non-discriminatory.

The value of the property is not only a reasonable basis for assessing a tax on the beneficial use, it is difficult to imagine how the value of the privilege could otherwise be determined on any fair and non-discriminatory basis. The inherent fairness and non-discriminatory nature of the tax is its greatest asset.

Appellants can point to no specific case or Constitutional provision invalidating the tax. Appellees can and do cite herein many decisions sustaining the tax in principle and practice. The burden is upon appellants to demonstrate that the tax "clearly and palpably violates the fundamental law" before the court is justified in holding it unconstitutional." *Clyde vs. Gilchrist*, infra. This appellants cannot do on the basis of either principle or authority.

ARGUMENT

There can be no question of a state's plenary power to tax the privilege of using tax-exempt property in connection with a busines conducted for profit, assuming, of course, the act imposing the tax does not otherwise infringe against any Constitutional prohibition.

> "Apart from the restrictions and limitations of its own, and the Federal Constitution's and in the absence of any compact with or cession of jurisdiction to the Federal government, a state's power of taxation is, where the subjects to which it applies are within the jurisdiction of the state, unlimited, plenary, absolute and supreme. * * *"
>
> 51 *Am. Jur.*, p. 83-84.

> "A state, acting through its legislature, may determine the persons, property, and privileges to be taxed, the mode, form, and extent of the imposition, the allocation of taxes between the state and its political subdivisions, and the manner and means of enforcement. Thus, a state has inherent legislative power to determine the subjects of taxation for general or for particular purposes and to make appropriate changes in the selections and classifications of the properties made subject to or exempted from taxation. It is not restricted to property taxes nor to any particular form of excises, and may adopt such new methods of taxation from time to time as may be found necessary. * * *"
>
> 51 *Am. Jur.* 85-86.

The power of a state to tax the privilege of using property, separate and apart from the property itself, was aptly described by the colorful language of Justice Cordozo in *Heneford vs. Silas Mason Co.*, 300 U. S. 577, p. 582 as follows:

> "The privilege of use is only one attribute, among many, of the bundle of privileges that make up property or ownership * * *. A state is at liberty, if it

> pleases, to tax them all collectively, or to separate the faggots and lay the charge distributively * * * Calling the tax an excise when it is laid solely upon the use * * * does not make the power to impose it less. * * *''

It is clear that Act 189 is valid unless it can be demonstrated that it in some way offends against the United States Constitution. Appellants contend the Act violates the rule of implied immunity.

Doctrine of Implied Immunity

The rule that the federal government, its agents and instrumentalities, are not subject to tax by the states or local units of government, does not rest upon any express Constitutional provision. It is said to arise by necessary implication from our dual system of government. We believe a brief review of the origin and development of the doctrine will be helpful to the Court.

The doctrine had its origin in the case of *McCullock vs. Maryland*, 4 Wheat 316. Congress had adopted legislation providing for the chartering of national banks. The measure was not without opposition. In retaliation, the State of Maryland adopted "An Act to impose a tax (10¢ per $5.00 in bank notes issued) on all banks or branches thereof in the State of Maryland, *not* chartered by the legislature." The tax was obviously discriminatory and aimed at the branch of the Bank of the United States established in Baltimore. In an opinion written by Justice John Marshall the court wisely and properly held the tax illegal. In keeping with the concept of law prevailing at the time, the doctrine of implied immunity was stated in absolute terms. It was supposed that if the power to tax a particular object existed at all, the power was unlimited and that the "power to tax involved the power to destroy." The immunity was likewise thought of and laid down in absolute terms.

The next major step came in *Van Brocklin vs. State of Tennessee*, 117 U. S. 151, decided shortly after the Civil War.

In the Van Brocklin case the United States had acquired title to certain land for delinquent taxes. The State of

Tennessee levied taxes on the land while title was held by the United States. It appears that the land was vacant and, since not devoted to a public use, it was contended no immunity existed. The court held the property immune on the theory that retention of the title by the United States as security for its taxes was a governmental function. The court was careful to point out in its opinion that "The United States does not and cannot hold property, as a monarch may, for private or personal purposes."

It seems to have been quite generally assumed since the Van Brocklin decision that all federally-owned property is immune regardless of the use to which the property is put. Such was not the holding of the Van Brocklin case and, though the issue is not directly involved in this case, it appears that such a broad application of the rule could be seriously challenged in view of the recent limitations placed upon the corresponding immunity supposedly enjoyed by the states. See 163 *A. L. R.* 542.

Though the court had been careful to point out in *McCulloch vs. Maryland* that "This opinion does not deprive the states of any resources which they originally possessed.", the doctrine was artificially extended far beyond its original import to exclude any tax that could conceivably affect the federal treasury.

In any event, application of the doctrine caused no particular difficulty for a hundred years or more. Federal activities remained on a limited scale. Even during periods of war, contracts for munitions were generally let to private concerns liable for the usual local taxes, so that the local units of government suffered but little from the application of the rule.

With the tremendous expansion of federal activities coming in the nineteen thirties it was inevitable that the impact of the extended and rigid doctrine of immunity be felt. Under the now repudiated test of the "burden of the tax" the application of the doctrine had reached absurd proportions. Any tax that remotely affected the federal treasury was stricken down. In *Gillespie vs. Oklahoma*, 257 U. S. 501, the states were denied the right to tax income derived from oil leases of Indian land. In *Rogers vs. Graves*, 299 U. S. 401, the salary of an employee of a government owned corporation was held immune from state tax. Early sales and use taxes met a similar fate

where federal agencies or even private contractors performing work for the Federal Government were concerned. *Panhandle Oil Co. vs. Mississippi*, 277 U. S. 218, 56 *A. L. R.* 583.

The foregoing decisions were not without dissent. The statement of Justice Holmes in his dissenting opinion in the Panhandle case that "The power to tax is not the power to destroy while this court sits" foretold a realization that the oft-quoted expression that "the power to tax is the power to destroy" was better rhetoric than law. 140 *A. L. R.*, p. 622.

As federal activities grew from a mere corner post office to the construction of huge dams, power plants, and later to ownership of gigantic mills and manufacturing plants, application of the immunity rule, "distorted by sterile refinements unrelated to affairs" (120 *A. L. R.* p. 1474) resulted in critical and frequently disastrous consequences.

The turning point came in *James vs. Dravo Contracting Co.*, 302 U. S. 134, 114 *A. L. R.* 318, upholding a West Virginia "Gross Sales and Income Tax" as applied to a contractor engaged in work for the Federal Government.

Rogers vs. Graves was overruled in *Graves vs. New York*, 306 U. S. 466, 120 *A. L. R.* 1466.

Gillespie vs. Oklahoma ceased to be law when *Oklahoma Tax Com. vs. Texas Co.*, 336 U. S. 342 was decided.

The "burden of the tax" test was completely repudiated in *Alabama vs. King & Boozer*, 314 U. S. 1, 140 *A. L. R.* 615, where the court first began to speak of the "legal incidence" of the tax as opposed to the "burden".

Panhandle Oil Co. vs. Mississippi, if not overruled by Alabama vs. King & Boozer, cannot stand in the light of the more recent decision in *Esso Standard Oil vs. Evans*, 345 U. S. 495, 97 L. Ed. 1174.

The immunity doctrine, presumed to apply with equal force to federal taxes relative to the state and local governments, underwent a similar metamorphosis in its application to state functions. *Collector vs. Day*, 11 Wall 113, holding the salaries of state officers to be immune from federal tax was overruled in Graves v. New York, supra. In these cases a distinction was made between functions "of a strictly governmental character" and those of a private nature. In *South Carolina vs. United States*, 199 U.S. 437, a federal liquor tax was upheld though the liquor was wholly owned

by the State of South Carolina and sold through its own dispensaries. The court held that "whenever a state engages in a business which is of a private nature that business is not withdrawn from the taxing power of the nation." Similar tests have since been applied in determining the extent to which state functions are immune from federal tax. See *United States vs. New York*, 140 F. 2d 608 and the annotation in 163 *A.L.R.* 542.

A number of tests have been applied in an effort to reach a satisfactory formula for application of the doctrine as to federal activities. They are briefly: (1) the "economic burden" test, now discarded; (2) the test of "degree" to which the federal government is affected, whether directly or remotely, which never gained general acceptance; (3) the "discrimination" test which is still recognized as valid; (4) the "legal incidence" test which evolved during the nineteen thirties and has been applied in most recent cases; and (5) the "governmental status" test which is not unlike the tests applied in determining the validity of federal taxes upon state functions.

No one test appears to be satisfactory, and, in view of ever changing conditions, it is doubtful if any precise formula can be laid down which will prove a panacea for this eternal problem. So long as we have a dual system of government the problem will necessarily exist and its solution necessarily varies with the changes brought by time.

A phenomenon occurring during the late World War has further complicated the matter and has again brought the problem into acute focus. Whereas in prior wars the federal government had, for the most part, let its contracts for the materials and munitions of war to strictly private concerns, many of the plants used to produce materials and munitions in the last war were built under the jurisdiction of the Defense Plant Corporation, a subsidiary of the Reconstruction Finance Corporation. Title to the land was generally taken by D.P.C. which financed construction of the plants. As in the instant case, the plant was then leased to a private concern, generally with an option to purchase, and the leasing concern given contracts for the manufacture of the materials desired. Such plants were subject to state and local taxes by express

statutory provision so long as title was held by D.P.C. or R.F.C.

At the end of the war, the Surplus Property Act was adopted to provide a means for getting such property back into private hands. However, because of lack of purchasers or other reasons, in many instances title wound up in the United States of America with the use of the property, by lease or otherwise, in the hands of private concerns engaged in strictly commercial activities for profit. See *Continental Motors Corp. et al vs. Twp. of Muskegon et al*, 346 Mich. 141 and *United States and Borg-Warner Corp. vs. City of Detroit*, No. 26.

Large and valuable properties are involved. These lands were not ceded by the state to the federal government nor were they purchased with the consent of the legislature of the state for the "erection of forts, magazines, arsenals, dockyards, and other needful building" pursuant to Art. 1, Sec. 8, Clause 17 of the United States Constitution. See *M.S.A.* 4.61. Title came to the United States, willy-nilly, by force of circumstances beyond the control of either government and probably against the desire of each.

With the foregoing background in mind, let us examine Act 189 to see if it violates the rule of implied immunity.

Does Act 189 Impose a Tax on Property of the United States?

Appellants contend that Act 189 imposes a tax upon federal property. The nub of the argument is that since the tax is measured by the value of property, it is therefore, a tax upon property. This precise contention is discussed further in this brief under the heading "Measure of the Tax."

The question of whether Act 189 is a property tax as opposed to a privilege tax is a matter of statutory construction. The Act was construed as imposing a privilege tax in both courts below. While the construction placed upon a statute by a state court is not binding on this court where a constitutional question is involved, the construction adopted by the state court will be given great weight. It was held in *Clyde vs. Gilchrist*, 262 U.S. 94, p. 97 that:

> "* * * when we are dealing with a matter of local policy, like a system of taxation, we should be slow

> to depart from their judgment, if there is no real oppression or manifest wrong in the result."

The burden is upon appellants to establish that the Act violates some express or implied Constitutional provision before the court will be justified in declaring the Act invalid.

It was held in *Mich. Central Ry. Co. vs. Powers*, 201 U.S. 245, p. 267, that:

> "The *presumption of constitutionality* following taxing statutes is stronger than applies to laws generally and *only where a taxing system clearly and palpably violates the fundamental law will it be held invalid.*"

Even without the benefit of presumption we believe it can be clearly demonstrated that Act 189 in no way offends against any Constitutional provision.

To avoid confusion in terminology it is well to look at the various classifications of taxes.

The United States Constitution, Art. I, classifies taxes as direct, (such as property, capitation and poll taxes) and duties, imposts and excises.

The Michigan Constitution, Art. X, classifies taxes as either property taxes or "specific taxes."

The term "specific taxes" as used in the Michigan Constitution is synonymous with "excises" as that term is used in the Federal Constitution. Both terms include what are generally referred to as "privilege taxes" 51 *Am. Jur.* p. 52-56.

Aside from capitation and poll taxes, which are direct taxes upon persons, the term "direct taxes" appears to be synonymous with "property taxes." All other taxes, not clearly poll taxes or taxes on property, are considered "excise" or "privilege taxes." See 51 *Am. Jur.* p. 52 and 47 *A.L.R.* 971.

Because of the constitutional requirement that direct taxes be apportioned, this court has frequently been called upon to determine what taxes are direct taxes upon property, as distinguished from an excise or privilege tax.

This question was first considered in *Hylton vs. United States*, 3 Dall 171 involving a carriage tax. It was claimed that the tax was a direct tax upon property and, since not apportioned according to population, was unconstitutional. "The question was deemed of very great importance, and was elaborately argued." *Ann. Cas.* 1912 B p. 1329. Though the reasoning of the opinion is not too clear, the generally accepted theory upon which the tax was upheld is "that the tax * * * was not levied directly on property because of its ownership but rather *on its use* * * *" *Brushaber vs. Union Pacific Ry. Co.*, 240 U.S. 1, *Ann. Cas.* 1917 B p. 714.

Nicols vs. Ames, 173 U.S. 509, involved a tax on sales made on an exchange or board of trade. After determining that "no microscopic examination as to the purely economical or theoretical nature of the tax should be indulged in for the purpose of placing it in a category which would invalidate the tax," the court continued at p. 518-519:

> "It is asserted to be a direct tax, because it is a tax upon the sale of property *measured by the value of the thing sold*, and such a tax is a direct tax upon the property itself * * *."
>
> "We think the tax is in effect a duty or excise *laid upon the privilege*, opportunity, or facility offered at boards of trade or exchanges for the transaction of the business mentioned in the act."

As pointed out in *Flint vs. Stone Tracy Co.*, 220 U.S. 107:

> "The distinction lies between the attempt to tax the *property as such* and to *measure a legitimate tax upon the privilege involved in the use* of such property."

Appellants contend that since the tax is measured on an "ad valorem" basis or "according to value" that the tax is a property tax. We recognize that this is one test frequently employed in determining the nature of a tax and that most property taxes are levied on an ad valorem basis. It does not follow, however, that because a tax is

measured on an ad valorem basis, it is necessarily a property tax. As pointed out in 51 *Am. Jur.* p. 53:

> "The modern tendency, however, is toward ad valorem taxation even in the case of excises, as being more consonant with justice."

And as stated in 51 *Am. Jur.* p. 246:

> "It is a well-settled principle, applicable particularly to excise and privilege taxes, that graduation of the rate or amount of a tax according to some reasonable scale, standard, or measure, which *usually has reference to the value* or amount *of the property used* in connection with, or the pecuniary benefit derived from, the act or privilege taxed, embraces no unlawful or unreasonable classification or discrimination."

Succession taxes are examples of privilege taxes measured strictly on an "ad valorem" basis. Though statutes providing for succession taxes seldom speak of the privilege of succession, and at first glance appear to be direct taxes upon the property transmitted, they are universally held to be privilege taxes and not taxes upon property. It was held in *Union Trust Co. vs. Probate Judge*, 125 Mich. 487 that the Michigan Inheritance Tax was a tax on "the privilege of succession" and that "the ad valorem feature" did not render the tax void as a tax on property "in that its amount is not arbitrary, but is based on the value of the property which is subject to the privilege." To the same effect, see *Snyder vs. Bettman*, 190 U.S. 249, 163 *A.L.R.* 566 and *United States vs. Perkins*, 163 U.S. 625, holding, incidentally, that the fact that the bequest was to the United States or a municipality did not afford an immunity from a succession tax. Also, the fact that the estate consists of Federal securities affords no immunity, *Plummer vs. Coler*, 178 U.S. 115. And these acts go much further than Act 189 and provide that the tax becomes a lien upon the property if not paid.

Sales and use taxes are measured by the price at which the property is sold (which is obviously its value) and thus have an "ad valorem feature" but are universally recognized as privilege taxes rather than taxes upon property.

In *Opinion of Justices*, 250 Mass. 591, 148 N. E. 889, cited 114 *A.L.R.*, p. 848, an annual excise tax for the privilege of operating a motor vehicle, based upon the manufacturer's list price, with certain allowances for depreciation, was upheld. The court said at page 600:

> "*Excises founded in part upon the value of the property utilized in the exercise of the privilege thereby taxed are common.* They involve no infraction of constitutional guarantees, provided in other respects they are genuine excise taxes. * * * An examination of the proposed bill plainly shows that it provides for an excise for the use of highways and not a property tax."

In the final analysis, whether a tax is regarded as a tax on property or a privilege tax, is determined by its characteristics, its qualities, its attributes, its operation, and its effect.

Aside from the ad valorem basis upon which the tax is measured, Act 189 has none of the characteristics of a property tax and all of the characteristics of a privilege tax.

It is clearly stated in the title of the Act that it is "an Act to provide for the taxation of *lessees and users* of tax-exempt property."

Whereas property taxes are invariably based upon ownership and are payable regardless of whether the property is used or not, Act 189 applies *only* when the lessee or user *makes use* of certain property in connection with a business conducted for profit.

Property taxes are regarded as a tax "against the property as a thing," whereas Act 189 imposes a purely personal liability upon the lessee or user.

Property taxes almost invariably become a lien upon the property which is the subject of the tax and the property is the thing looked to for collection. The tax imposed by Act 189 becomes "a debt due from the lessee or user" recoverable only in an action of assumpsit.

Appellants rely heavily upon some language used by the court in the cases of *United States vs. Allegheny County*, 322 U.S. 174, *Macallem Co. vs. Massachusetts*, 279 U.S. 620, and *Miller vs. Milwaukee*, 272 U.S. 713. The cases do not hold what appellants claim for them.

(a) *The Allegheny County Case*

In the Allegheny County Case, Mesta Machine Company entered into a contract to manufacture guns for the United States. Mesta's plant was not equipped with the necessary machinery for the work. Some of the machinery was furnished by the government; some manufactured by Mesta, and some purchased from other manufacturers for which Mesta was reimbursed by the government. Mesta's contract with the government provided that "title to all such property should vest in the government." The machinery was bolted on concrete foundations in the plant. "It could be removed without damage to the building."

The machinery was assessed as part of the real estate and its value added to the value of the plant. The assessment was made as follows: "Land, $293,795.00; Building, $1,123,124.00; Machinery, $2,489,085.00; Total Assessment, $3,906,004.00."

The court held, p. 183:

> "We hold that title to the property in question is in the United States and is effective for tax purposes."

This holding actually decided the case. Since the machinery had not become part of the realty by virtue of its being bolted to concrete foundations it was not, therefore, taxable property of the Mesta Company.

The court went on to point out, p. 184:

> "It is not contended that the scheme of taxation employed by Pennsylvania is anything other than the old and widely used ad valorem general property tax * * * this form of taxation is *not regarded primarily as a form of personal taxation*, but rather as a *tax against the property as a thing*."

The court held the tax invalid insofar as it was upon property owned by the United States.

In the instant case we are dealing with a privilege tax and not a general property tax. Act 189 does not impose a tax against property "as a thing." It imposes a purely personal liability upon the "user" of property, and then

only when the use is in connection with a business conducted for profit.

The court took the pains to point out in the Allegheny County Case, p. 186-188:

> "Mesta has some legal and beneficial interest in this property. It is a bailee for mutual benefit. *Whether such a right of possession and use in view of all the circumstances could be taxed by appropriate proceedings we do not decide* * * *
>
> "Actual possession and custody of government property is nearly always in someone who is not himself the government but acts in its behalf and for its purposes. He may be an officer, an agent, or a contractor. *His personal advantages* from the relationship by way of salary, profit, or *beneficial personal use of the property may be taxed* as we have held."

Act 189 does exactly what the court suggested might be done in the Allegheny case.

(b) ***The Esso Standard Oil Case***

Appellants' contention that the tax is "on" the property cannot stand in view of the recent holding in the case of *Esso Standard Oil vs. Evans*, 345 U.S. 495. In that case a tax of $196,000.00 assessed against Esso Standard Oil Company under a state tax on the privilege of storing gasoline was sustained. The gasoline involved was owned by the Defense Supply Corporation and was specifically exempted from state storage and use taxes by 55 *Stat.* 248. Esso had contracted to store the gasoline for the government. The government agreed to assume liability for all state taxes.

The tax was paid under protest and suit brought for recovery. United States Government intervened and took the position that the tax violated the rule of immunity. The appellants relied upon the Allegheny County case. The court said, p. 498 and 499:

> "The appellants take a firm stand on United States v. Allegheny County, 322 U.S. 174, which they con-

tend is an analogous case that compels reversal of this decision. They say in effect that the tax here is no less 'on' the property of the Federal Government than it was in that case."

The court very readily distinguished the Allegheny County case on the ground that the tax was a privilege tax and not a tax "on" the federal property. The court went on to point out, p. 499 and 500:

> "Federal ownership of the fuel will not immunize such a private contractor from the tax on storage. It may generally, as it did here, burden the United States financially. But since James v. Dravo Contracting Co., 302 U.S. 134, this has been no fatal flaw. We must look further, and find either a stated immunity created by Congress in the exercise of a constitutional power, or one arising by implication from our constitutional system of dual goverment."
>
> "Neither condition applies to the kind of governmental operations here involved. There is no claim of a stated immunity. And we find none implied. *The United States today is engaged in vast and complicated operation in business fields*, and important purchasing, financial, and contract transactions with private enterprise. *The Constitution does not extend sovereign exemption from state taxation to corporation or individuals, contracting with the United States, merely because their activities are useful to the Government. We hold, therefore, that sovereign immunity does not prohibit this tax.*"

In the Esso case the state was taxing Esso because of its possession of government-owned property for storage. Act 189 taxes Continental because of its possession and use of government-owned property. Tennessee taxed the privilege of "storing" tax-exempt property in connection with a business conducted for profit. Act 189 taxes the privilege of "using tax-exempt property in connection with a business conducted for profit." In neither

instance is the tax "on" property of the federal government.[1]

The Michigan Supreme Court recently made the following observation relative to the Esso case in *Federal Reserve Bank vs. Revenue Dept.*, 339 Mich. 587, p. 597-598, decided June 7, 1954:

> "Similarly, in *Esso*, *in the course of distinguishing that case from United States v. Allegheny County* 322 U.S. 174 (64 S. Ct. 908, 88 L. ed 1209), the reasoning of the Court seems to boil down to that same concept, that *it is the legal incidence* and not the economic burden of a State tax *to which the immunity or statutory exemption of a Federal instrumentality extends* and that exemption of the intermediate person upon whom the *legal incidence* of the tax falls is *not to be implied*, regardless of the fact that it passes its burden on to the United States, so long as Congress has not expressly exempted such person therefrom."

The legal incidence of the tax under Act 189 falls squarely on Continental. The tax is not "on" property of the federal government and does not violate the rule of federal immunity. It is on the "user" and is imposed upon the privilege of using tax-exempt property in connection with a business conducted for profit.

(c) *Educational Films Corporation Case*

The case of *Educational Films Corporation vs. Ward*, 282 U.S. 379, 71 *A.L.R.* 1226, is directly in point. In that case a New York statute which imposed a franchise tax

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[1]While it is true that in the course of distinguishing the Allegheny County case the court did make reference to the fact the tax was not "based on the worth of the government property", this observation was neither essential or controlling to the decision. In the final analysis it is the reasonableness of the measure of the tax that controls. A tax graduated according to the "amount" of gasoline stored cannot be said to be inherently more reasonable than a tax graduated according to the "value" of the gasoline stored.

of 4½% of the entire net income of a corporation was challenged where the assets of the corporation consisted in most part of ownership of certain copyrights. It was assumed that copyrights and royalties received therefrom were immune from tax. (It was later held otherwise in *Fox Film Corporation vs. Doyle*, 286 U.S. 123) but the reasoning of the Court is significant. It was claimed as a ground for invalidity that, since the tax was measured by tax-immune property, it amounted to a tax upon the property itself. The Court had this to say at p. 391:

> "So well settled is this last-mentioned application of the doctrine that *an excise may be measured by tax-immune property*, that an appeal in which such a tax was assailed on the very grounds urged here were dismissed per curiam during the present term * * * "
>
> "It is said that there is no logical distinction between a tax laid on a proper object of taxation, measured by a subject-matter which is immune, and a tax of like amount imposed directly on the latter; but it may be said with greater force that *there is a logical and practical distinction between a tax laid directly upon all or any class of government instrumentalities*, which the Constitution impliedly forbids, *and a tax such as the present which can in no case have any incidence, unless the taxpayer enjoys a privilege which is a proper object of taxation*, and which would not be open to question if its amount were arrived at by any other non-discriminatory method."

The tax imposed by Act 189 "can in no case have any incidence" unless someone enjoys the privilege of using tax-exempt property "in connection with a business conducted for profit." Unlike a property tax, which applies regardless of whether or not the property is being used, the tax imposed by Act 189 applies only if the specified property is used in connection with a business conducted for profit.

Appellants claim that the tax is a tax "on" the property because measured by its value is without merit.

(d) *The Macallem Co. and Miller vs. Milwaukee Cases*

Appellants claim Act 189 is "special legislation" aimed at federally-owned property. If by this appellants mean that, in order to impose a just tax on those enjoying the special privilege of using tax-free property in connection with a business conducted for profit the Michigan legislature intended to include the privilege of using federally-owned property, appellants are correct. If appellants mean that the Michigan legislature intended to single out federally-owned property and impose a special tax on its use — a tax not borne by users of exempt property in general — appellants are 100% wrong as is apparent from a reading of the Act.

Appellants rely upon *Miller vs. Milwaukee*, 272 U.S. 713 and *Macallem Co. vs. Massachusetts*, 279 U.S. 620, to support their contention.

In Miller vs. Milwaukee the tax was measured *solely* by income from federal bonds which were expressly exempt from taxation. In Macallem Co. vs. Massachusetts the tax was a franchise tax based on "net income" which by amendment was made to specifically include *only* interest from exempt bonds.

The holding of these cases were clarified somewhat in Educational Film Corp. vs. Ward, supra, p. 392.

The court further limited and qualified those decisions in *Pacific Co. vs. Johnson*, 285 U.S. 480, at p. 493:

> "The view that a tax, although levied on a taxable subject, may be deemed invalid because purposely levied to include a non-taxable subject in its measure, receives only a limited and qualified support from Miller vs. Milwaukee, supra. There a state statute taxing corporate dividends was framed in such manner as to tax them only so far as they were derived from corporate income from tax-exempt bonds of the United States. The taxing act thus, on its face, *did more than exhibit an intention of the one sovereign to include in the dividends taxed, those derived from income from a non-taxable instrumentality* of the other, *together with income from all other sources. That admittedly would have been permissible; * * * But it was the exclusion from the measure*

of the tax of all income except from federal bonds which rendered the tax invalid.",

With certain limited exceptions, Act 189 applies to all real property "which for *any reason is exempt* from taxation." State-owned, county-owned, municipally-owned property, and property owned by churches, hospitals and other charitable institutions, if put to commercial use, is included in the measure of the tax imposed by Act 189.

The Macallem case was further distinguished in *Hale vs. Iowa State Bd. of Assessment and Review*, 302 U.S. 95, where the court pointed out that, under Massachusetts law, an income tax was classified as a tax "on property" thus emphasizing the significance of the language in the Pacific Co. case, p. 490:

> "It suffices to say that the tax immunity extended to property * * * does not embrace a special privilege * * * otherwise taxable, merely because the value of the * * * property * * * is included in an equable measure of the enjoyment of the privilege. The owner may enjoy his exempt property free of tax, but if he asks and receives from the state the benefit of a taxable privilege as the implement of that enjoyment, he must bear the burden of the tax which the state exacts as its price."

The privilege of using tax-free property in a business conducted for profit is clearly a privilege for which a state may exact a tax. Continental must bear the burden of the tax which the state exacts as its price for the exercise of the privilege.

Does Act 189 "Result" in a Direct Imposition of Tax upon Property?

Appellants contend Act 189 *results* in a tax upon federal property, and is therefore, invalid. If appellants' contention were sound it would invalidate virtually every federal excise from the first carriage tax to the multitude of excise taxes now in effect.

Consider, for example, the following:

Title 26, Sec. 4013 reads:

"There is *hereby imposed upon the following articles* sold at retail a tax equivalent to 10 per cent of the price for which so sold: Articles made of fur on the hide or pelt; and articles which such fur is the component material. * * *"

Title 26, Sec. 4021 provides:

"There is *hereby imposed upon the following articles* sold at retail a tax equivalent to 10 per cent of the price for which sold:

Perfume	Pomades	Hairdressing
Extracts	Hair restoratives	

* * *"

Title 26, Sec. 4091:

"There is *hereby imposed upon lubricating oils* sold in the United States by the manufacturer or producer a tax at the rate of 6 cents a gallon * * *"

Title 26, Sec. 4301:

"There shall be *imposed a tax on each original issue of shares or certificates of stock*, issued by a corporation * * *"

Title 26, Sec. 4501:

"There is *hereby imposed upon manufactured sugar* manufactured in the United States, a tax, to be paid by the manufacturer at the following rates: * * *"

At first glance, all of the above acts would appear to impose, or at least *result* in, a direct tax upon the property specified. Yet, all of the foregoing Acts are regarded as imposing a tax upon the privilege of manufacture, sale, transfer or some other privilege exercised relative to the property; for Congress has no power to impose a direct tax on any of the items of property mentioned without apportioning same according to population. Art. I, Sec. 9, C. 4, *U. S. Constitution.*

If, as appellants contend, a tax on a privilege exercised relative to certain property, if, measured by the value of the property, is to be treated as *resulting* in the imposition of a direct tax upon the property itself, it necessarily follows that all of the above taxes are void. Such is simply not the law. All of the foregoing taxes have been sustained as valid excises imposed upon some privilege exercised relative to property, though the tax in most instances is measured by the value of the property.

Appellants seek to demonstrate that the tax is "on the whole of the property" by the hypothetical case of certain parcels of land designated A, B and C, all of equal value and each used commercially for profit. Parcel A is privately owned and subject to the General Property Tax. Parcels B and C are tax-exempt but leased for 75 years and five years respectively, to tenants who use them commercially. Appellants complain that the lessees of parcels B and C pay the same amount of tax each year under Act 189 and that their tax is also the same in amount as the owner of parcel A pays under the General Property Tax. What appellants overlook is the fact that, other factors being equal, the "privilege of use" enjoyed by the lessees of parcels B and C is of equal value during any given year. Appellants also overlook the fact that the privilege of use enjoyed by the lessees during a given year is equal in value to the privilege of use which the owner of parcel A enjoys by virtue of his ownership. Viewed as a tax on the "privilege of use" it is readily apparent that the lessees of parcels B and C should be taxed equally since they enjoy an equal privilege. It is also readily apparent that the tax paid by the lessees of parcels B and C should be equal to the tax paid by the owner of parcel A (who uses his land for the same purpose and thus derives no greater benefit from it during a given year) and is taxed by virtue of the ownership from which his privilege of use is derived.[1]

Appellants claim the fact that the tax is equal in each instance proves that the tax is on "the whole of the prop-

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[1]Additional privileges the owner of parcel A has, such as sale, mortgage, etc. are subject to additional excise taxes if exercised.

erty." It proves just the opposite. The reason the tax is equal is that each enjoys an equal privilege.

Applying the same analogy to the widely accepted use tax we have the following:

A, B and C each buy an automobile on the same day for $3,000.00 subject to a 3% use tax. A's car is demolished in an accident the next day. B drives his car one year. C drives his car five years. A enjoyed little by way of "privilege of use." B enjoyed more, and C still more use. Yet all pay the same use tax. It is ridiculous to contend that because the tax was the same in each case that the tax was, therefore, "on the property" rather than the privilege of use.

Or, take the hypothetical situation of A, B and C selling perfume subject to Title 26, Sec. 4021. All sell at the same price. A makes a 10% profit on his sales, B makes a 15% profit, and C a 30% profit. It would be ridiculous to argue that the tax is "on" the perfume rather than the privilege of sale simply because each pays the same tax. The answer is that each enjoys the same privilege, namely, the privilege of sale.

Use Limited to Performance of Government Contracts

Appellants contend that the tax is invalid as applies to this particular case because Continental's use of the premises is confined to fulfilling contracts with the federal government. While it is true the property is being used in this particular instance and at this particular time solely for the production of material for the Army, we have no assurance that such will continue to be the case. See *United States and Borg-Warner Corp. vs. City of Detroit*, No. 26, presently on appeal to this court.

The argument is an equitable rather than a legal one. Though at first glance the argument has a degree of plausibility, it will not bear analysis, and definitely is not the law.

Directly in point and, we believe, conclusive of the issue, is *Curry vs. United States*, 314 U.S. 14, which should be read in the light of its companion case, *Alabama vs. King & Boozer*, 314 U.S. 1, 140 A.L.R. 615.

In the Curry case the respondent was performing work for the Government under a cost-plus contract. Respond-

ent had purchased a quantity of roofing material outside the State of Alabama which was shipped to an Army camp-site for use in performing the contract. The contract provided that title to such materials should vest in the Government "upon delivery at the site of the work or at an approved storage site and upon inspection and acceptance in writing by the Contracting Officer." See *Alabama vs. King & Boozer*, 314 U.S. 1, 140 A.L.R., p. 619.

The court held the respondent liable for the Alabama use tax imposed upon the "storage, use or other consumption in the state of tangible personal property purchased at retail." Thus the privilege of using property owned by the federal government was held subject to tax though the privilege of use was limited to the sole purpose of fulfilling a contract with the federal government.

Appellants' claim that Continental "is strictly an agent or instrumentality for the United States" is answered in *Heneford vs. Silas Mason Co.*, 300 U.S. 577, where the plaintiffs, contractors and sub-contractors for construction of Grand Coulee Dam, had purchased extensive machinery and supplies in other states and brought them into the State of Washington for use in performance of their contracts. The Washington use tax was imposed and sustained. The claim made in the lower court (Silas Mason Co. vs. Heneford, 15 Fed. Supp. 958) "That the construction of the dam upon which plaintiffs are engaged under their contract with the United States is a government work in prosecution of which the Executive Department of the United States is exercising a franchise granted by Congress to construct a dam * * * to the end that navigation may be improved * * * and that * * * the plaintiffs are employed as agencies and instrumentalities of the United States, and their property is exempt * * *" was apparently abandoned on appeal.

In *General Construction Co. vs. Fisher*, 39 P. (2nd) 358, 97 A.L.R. 1252, the plaintiff's sole business in Oregon was the construction of a dam under a contract with the Department of Interior. However, the Oregon tax on "net income," in this instance derived solely from the government contract, was sustained. And, the same result was reached in *Ralph Sollett & Sons Construction Co. vs. Comm.*, 161 Va. 854, 91 A.L.R. 774, appeal dismissed, 292 U.S. 599, where the plaintiff's business consisted ex-

clusively of constructing a post office under a contract with the federal government.

In *Wilson vs. Cook*, 327 U. S. 475, the appellant was held liable for a tax on the privilege of severing trees though the trees were cut from a national forest reserve, under a contract with the United States.

In each of the above cases, some privilege, limited and exercised solely for the purpose of performing a contract with the federal government, was held subject to tax. None of the contracting parties were regarded as an "agent or instrumentality" of the United States within the meaning of the immunity rule.[1]

Appellant Continental's claim that it "is strictly an agent or instrumentality for the United States, using facilities of the United States to produce for the United States" and, inferentially, that it is not, therefore, subject to tax, is even more fully answered in *Kaiser vs. Reed, et al (United States, Intervenor)* (Cal. 1947) 184 Pac. (2d) 879.

It was apparently in deference to the Kaiser decision that the Military Leasing Act was amended and that Appellants concede Continental's "possessory interest" is subject to tax.

In the Kaiser case a tax was levied on the so-called "possessory interest" of lessees and occupants under the California General Property tax. See Sec. 107 of Cal. Rev. and Taxation Code.

The Kaiser Company was in possession of ship-building facilities owned by the government. Kaiser's use of the premises was "for the sole purpose of constructing vessels" for the government under a cost-plus contract. The contract was "not transferrable" and contained an "optional cancellation clause" in favor of the government. Thus the factual background of the Kaiser case and the present case are parallel.

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[1] The only case that might be regarded as contrary to this view is *Kern-Limerick, Inc. vs. Scurlock*, 347 U. S. 110, involving an Arkansas sales tax. In that case the contractor was held to be "a private purchasing agent" for the government. Since the purchases were regarded as "made by the Government" the sales were held non-taxable. The case is thus readily distinguishable.

While it is true, the assessor applied an artificial and quite complicated formula to determine the supposed value of Kaiser's so-called "possessory interest", which was considered less than the fee, it should be kept in mind that the tax in that case was supposed to be a property tax rather than a privilege tax. In any event, that consideration goes to the question of the measure of the tax rather than the subject of the tax. Though the court in the Kaiser case termed the right of possession a "species of property" it is clear from a reading of the opinion that the thing taxed was, in reality, the privilege of use. As stated in that case, p. 886:

> "* * * plaintiff's assessment stemmed from its use of the land and facilities in the shipyard as essentials to its production of ships at a profit, a right of possession consistent with its operation as an entrepreneur in business for its own account."

Measure of the Tax

It has already been demonstrated that non-taxable property may be included in the measure of a tax imposed upon a taxable privilege enjoyed in connection with the use of such property. Appellants complain that the full value of the property is used as the measure and contend that this is arbitrary.

The principle involved is far from new. It is interesting to note the similarity between Act 189 and *Anno. Laws of Mass.*, C. 59 Sec. 3,e which reads in part as follows:

> "Real estate owned by or held in trust for the benefit of the commonwealth or a city or town, *if used or occupied for other than public purposes*, shall be taxed to the lessee or lessees thereof, or their assigns, or to the occupant or person in possession thereof, *in the same manner and to the same extent as* if the said lessees or their assigns or the occupant or *person in possession were the owners thereof in fee*, free of any trust."

And see the annotation in 23 *A. L. R.* 248, p. 253, where the following reasoning is used in a case cited:

> "The obvious difference between a leasehold of privately owned land the value of the fee of which is assessed against the owner, and one of public land the fee of which is not taxable, affords a tangible and reasonable basis for the classification and a different method of assessment. And we think that *the provision that the value of leaseholds of public lands should be taken as that of the fee of the land demised, even though it may greatly exceed the actual value of the leasehold interest, is not, under the circumstances, open to objection.*"

Appellants contend the foregoing are property taxes and apply only to state or municipally-owned land. The question is the *reasonableness* of using the full value of the fee as the measure of the tax where the beneficial use is in private hands. If reasonable as to a property tax it is equally reasonable as to a privilege tax. The thing taxed in both instances is, in reality, the beneficial use of exempt property.

Appellants stress the fact that the tax does not apply insofar as federally-owned property is concerned if payments in lieu of taxes are made relative to such property. We can think of no way to make the tax more palpably unfair and unjust than to make it apply in such instances. There would be some merit to a claim that the tax is discriminatory if it applied under such circumstances. The chief virtue of the tax is that it equalizes the burden of local governments by imposing an equivalent tax upon those who enjoy the unique privilege of having the beneficial use of exempt property in connection with a business conducted for profit.

The case of *S. R. A. Inc. vs. Minnesota*, 327 U. S. 558, cited by appellants, supports the view that it is reasonable to tax one, having the beneficial use of property on the basis of the full value of the fee, even though his proprietary interest may be considerably less than a fee interest. In that case the petitioner was purchasing a vacant post office from the government. "The major portion of the contract price had not fallen due and was unpaid." A tax based upon the full value of the fee was sustained

against the claim that the state had "included the interest of the United States" and "subjected that interest to taxation."

We can hardly think of any reasonable or practical measure of a tax upon the privilege of using exempt property in connection with a business conducted for profit without looking to the value of the fee. The value of the privilege of use necessarily varies in direct proportion to the value of the fee. The value of the use at any given time is the same whether it is exercised by a mere licensee, a tenant for years, or by the owner of the fee. Continental Motors Corporation derives exactly the same benefit from the *use* of the property during any given year whether it has a lease for 99 years, a lease for 5 years, or a mere license during that year.[1]

Non-Discriminatory Character of Act 189

Appellants do not contend here, as they did in the courts below, that Act 189 discriminates against the federal government or the users of federally-owned property. Both courts below commented on the non-discriminatory character of the Act (R. 214-215; 225-227).

The inherent justice and fairness of the tax imposed by Act 189 is readily apparent. It is obvious that where a large and valuable piece of property (cost, $8,352,768.30, with a rental value of $364,032.00 per year) is turned over, rent free and tax free, to a private concern for use in connection with its business conducted for profit, the recipient indeed enjoys a unique and value privilege. Both the classification of those enjoying such special privilege as a subject for tax and the measuring of the tax on a basis which equalized the burden with those not so favored, is obviously reasonable and just.

The undesirability of a few exercising such a special privilege in an economy based upon free and equal com-

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[1] While it is true, if Continental's right of use should be terminated in any year shortly after tax day, it would not receive the full benefit of the property for that year. Unfortunately, there is no other practical way to administer the tax. A taxpayer whose house burns the day after assessment suffers a similar misfortune.

petition is readily apparent. And we believe this is true even though the competition may be temporarily limited to the bidding for contracts with the federal government. Not only is the tax imposed by Act 189 fair and non-discriminatory, it reflects a sound and healthy public policy.

Appellants stress the largess of the federal government in making payments in lieu of taxes. It suffices to say that no payments were made in lieu of taxes as to the property involved here in 1954. Seemingly the federal government, with all its multitudes of bureaus, agencies and vast instrumentalities, forgot that Orchard View School District was required to educate the children of the employees of the Continental plant in 1954. Somehow it was forgotten that the County of Muskegon was required to furnish roads and other services used by the employees at the plant in common with other citizens of the community. It was forgotten that the Township of Muskegon was required to afford fire protection for all property in the Township, including the Continental Plant, during 1954.

We do not believe that local self-government has come to hang on such a tenuous thread that it may be effectively destroyed through oversight or the whim and caprice of a particular Congress.[1] We believe local self-government still retains the power of self-preservation.

We do not allude to the fact that the lands and plant involved here comprised some 52% of the assessed value of Orchard View School District prior to 1954 (R. 226) as a plea for equity. We point out that fact to bring the basic issue into bold relief. The issue is a judicial one rather than one for the legislature. Just as the whole doctrine of governmental immunity had its origin in a decision of the court, it is for the court to determine the proper scope and application of the doctrine in the light of the realities of present day affairs.

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[1]Though similar legislation had been introduced in prior sessions of the Congress (see, for example, H. R. 206, introduced January 3, 1953) no legislation providing for payments in lieu of tax relative to the property involved here was adopted until *Public Law* 388 of 1955. That Act is temporary in nature and is effective only until December 31, 1958.

CONCLUSION

The judgment of the court below should be affirmed.

Respectfully submitted,

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